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RUEHGV/USMISSION GENEVA 1551
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SUBJECT: KYRGYZSTAN: GOVERNMENT FACES 2010 BUDGET DEFICIT

REF: BISHKEK 409

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11. (SBU) SUMMARY: An International Monetary Fund Mission visiting Kyrgyzstan reported that the stimulus provided by international assistance and a good harvest should help keep economic growth slightly positive in 2009. They were cautiously optimistic that Kyrgyzstan's economy would grow by about three percent in 2010, although the risk of a "double dip" economic slow down remains. The team gave the Kyrgyz Central Bank high marks for management of its currency and the banking sector. The main problem the government faces in the near future is financing its 2010 budget, and prospects appear slim that Kyrgyzstan will receive enough international assistance to cover its budget shortfall. End Summary.

Growth To Pick Up Slowly (Maybe)

12. (SBU) An International Monetary Fund (IMF) Mission visiting Kyrgyzstan to review the Exogenous Shocks Facility (ESF) program gave a briefing to international donors on September 23. In December 2008, the IMF Board approved an 18-month ESF for Kyrgyzstan with a total disbursement of SDR 66.6 million (approximately USD 100 million). The IMF Mission visited Kyrgyzstan in September as part of the second review of the ESF program. Nadeem Ilahi, IMF Mission Chief for Kyrgyzstan, said that the IMF estimates that Kyrgyzstan's GDP will grow 1.5 percent in 2009, slightly higher than estimates earlier this year. The country escaped falling into recession thanks to financial assistance from Russia and the IMF, including a USD 150 million grant from the Russian government (reftel). In addition, a good harvest this year provided an additional boost to the economy. However, a drop in exports, mainly to Kazakhstan and Russia, and a steep decrease in remittances from Kyrgyz workers in these countries slowed the economy. Ilahi noted that in June and July remittances were down 30 percent from the previous year, depressing domestic consumption.

¶3. (SBU) The IMF estimates that Kyrgyzstan's economy will grow three percent in 2010. However, Ilahi cautioned that this estimate depends upon the Russian and Kazakh economies not deteriorating any further. He said that if exports and remittances continue to fall, Kyrgyzstan risks a "double dip" economic crisis. In this scenario, government stimulus would push growth up briefly before it slows again due to lack of consumer demand. In any case, Ilahi said, there are no obvious engines of strong growth for Kyrgyzstan's economy in the short to medium term.

Central Bank Performing Well

¶4. (SBU) Ilahi gave the Kyrgyz Central Bank high marks for its handling of the depreciation of the currency, the som, and management of the banking system. The Central Bank, according to Ilahi, managed a smooth and steady depreciation of the som without using excessive amounts of reserves. The banking sector is adequately capitalized, without significant liquidity problems or a high level of non-performing loans. However, credit growth has fallen sharply as banks reacted cautiously to the economic slow-down.

A Large, But Unclear, Budget Gap in 2010

¶5. (SBU) The most significant economic problem the government currently faces is a large projected budget shortfall in 2010. The IMF calculates that the government's 2009 primary budget deficit, before accounting for grants from donors, will be 8.8 percent of GDP. Donor assistance has allowed the government to continue without major spending cuts this year. However, the government again faces a large budget shortfall in 2010. Kyrgyz government officials have told donors they need an additional USD 150 million to cover

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government spending in 2010. The IMF team said that the Kyrgyz government's figures do not yet give a clear picture of the size of the projected budget deficit. However, they confirmed that, whatever the precise number, the government faces severe budget problems in 2010 due to lower tax revenues and some increases in social spending.

¶6. (SBU) Earlier this year, the Kyrgyz government received a USD 300 million loan on concessional terms as part of the assistance package from the Russian government. The government plans to use most of that money to create a new economic development fund that would provide funding for private sector projects. Some of the participants at the IMF briefing argued the government should use that money to cover their budget gap, rather than asking for additional money from donors. A Russian Embassy representative attending the IMF briefing said that the money had been given with the understanding it would be used for private sector development, but that, as a sovereign country, the Kyrgyz could use the money as they saw fit. Ilahi said that government representatives had promised the IMF to use some of the Russian loan money to partially plug the budget gap, but had stood firm on using most of it to stimulate the private sector.

¶7. (SBU) The donors represented at the meeting noted the following possible budget support to the Kyrgyz government: the IMF Board will consider an additional USD 20 million, the World Bank Board will consider providing USD 30 million, the Swiss government may provide an as yet undetermined amount, the EU will provide no additional support, ADB is unlikely to provide additional support, and EBRD does not provide direct budget support. The Russian Embassy representative did not say whether any additional Russian support would be provided.

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